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DEC - 9 2010

UNITED STATES BANKRUPTCY COURT
UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re) Case No. 10-35071-A-12L
PRATT VINEYARDS, LLC,)
Debtor.)

)

MEMORANDUM

The chapter 12 debtor has proposed a plan of reorganization. A secured creditor, ReProp Investments, Inc., objects to the plan's confirmation, asserting that the plan is not feasible and that its treatment of its secured claim does not comply with 11 U.S.C. § 1225(a)(5)(B) grounds.

As filed, the plan proposes monthly payments of \$4,650 for 36 months. The only secured claim to be paid belongs to ReProp. General unsecured creditors, who hold claims totaling \$32,500 will receive a 100% dividend. Including trustee compensation, estimated at 10% of the amount distributed to unsecured creditors, it will take approximately \$933 a month to retire the unsecured claims over 36 months.

According to ReProp's proof of claim, it was owed \$719,250.14 on the date the bankruptcy case was filed. The promissory note executed by the debtor provides for interest

1 accrual at the rate of 12.5% and a maturity date of June 1, 2011.

2 No objection has been filed to the proof of claim.

3 As filed, the plan proposes to pay \$3,865 a month for 26
4 years on account of ReProp's secured claim. The claim will
5 continue to be secured by its existing real and personal
6 collateral and will accrue interest at the rate of 4.75%.¹

7 At the confirmation hearing, the debtor amended the plan to
8 require payment of ReProp's claim in 16, rather than 26, years
9 and to increase the monthly distribution to ReProp to \$4,517.

10 However, with interest at 4.75%, a principal balance of
11 \$719,250.14, and a monthly payment of \$4,517, it would take
12 approximately 252 months to pay ReProp's claim in full. Thus, at
13 the end of 16 years, there will be a remaining principal of more
14 than \$240,000 that must be paid by the debtor.

15 Section 1225(a)(6) requires that a chapter 12 debtor prove
16 that it will be able to make all payments required by the plan.
17 In other words, the plan must be feasible. ReProp asserts that
18 the debtor will be unable to make the required payments. The
19 court agrees.

20 The members of the debtor, David and Kim Pratt, are chapter
21 13 debtors in a related case, Case No. 09-36899. They reported
22 in their individual case that their interest in the chapter 12
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25 ¹ Because the plan requires that approximately \$209 be
26 paid to counsel for the debtor and a further \$933 be paid to the
27 unsecured creditors and the trustee, there will be only \$3,508
28 available to pay ReProp. As written, then, the plan is not
feasible because it will not fund the \$3,865 dividend promised
ReProp. This problem is exacerbated by the oral amendment to the
plan which requires that ReProp receive \$4,517 a month.

1 debtor had no value.² Further, given the minimal income being
2 received by the Pratts from the chapter 12 debtor, approximately
3 \$2,200 a month, and given that their chapter 13 plan will pay
4 only a 1% dividend to unsecured creditors over a 36-month plan
5 duration, it is unlikely the chapter 12 debtor will be receiving
6 any equity infusions from the Pratts.

7 The debtor's tax records do not paint a pretty picture. In
8 2009, the debtor reported a net loss of more than \$88,000.
9 Apparently, this financial performance was not unusual. The 2009
10 federal income tax return reports that the Pratts' capital
11 accounts were (\$627,254), indicating that the debtor had been
12 reporting income losses for many years.

13 This picture does not improve even when one considers the
14 tax returns of the related entity, DK Cellars, which merged into
15 the debtor in March 2010. As explained to the court, the debtor
16 grows the grapes which are made into wine by DK Cellars and then
17 sold to the public.

18 DK Cellars' tax return for 2009 reported business income of
19 \$21,213. Adding the depreciation expense claimed reported on DK
20 Cellars' 2009 tax return brings its net income up to just \$45,639
21 in 2009. Combined with the loss reported by the debtor, the two
22 entities were still operating at a loss.

23 And, like the tax returns of the debtor, the returns of DK
24 Cellars indicate a history of financial loss. In 2009, the

25 _____
26 ² Not only does the Pratt's Schedule B indicate that
27 their membership interest in Pratt Vineyards has no value; it
28 also indicates that their interest in a related company, DK
Cellars, has no value. These two entities were merged in March
2010.

1 capital accounts of the equity owners, the Pratts, was
 2 (\$365,570).

3 While past financial performance is significant, that
 4 performance alone is not determinative. If it were, many debtors
 5 would be unable to prove the feasibility of a reorganization
 6 plan.

7 The court heard lengthy testimony from David Pratt regarding
 8 the debtor's efforts to become profitable and the reasons for the
 9 dismal financial performance of the debtor and DK Cellars.

10 As the court understands it, debtor's financial difficulties
 11 have their root in the construction of the winery. In 2004 and
 12 2005, while the winery was being constructed and occupied by the
 13 debtor and DK Cellars, the Pratts exhausted their own financial
 14 resources. This prompted them to turn to ReProp which provided
 15 the financing to complete the winery.

16 In connection with the financing, the Pratts provided ReProp
 17 with projections of sales from 2006 through 2008 for the
 18 debtor/DK Cellars. The table below recounts their projections
 19 and the corresponding performance:

	2006	2007	2008	2009
Projected	\$144,200	\$201,000	\$264,000	n/a
Actual	\$143,113	\$168,791	\$274,582	\$227,253
Difference	(\$1,087)	(\$32,239)	\$10,582	n/a

24
 25 The table includes the sales of the debtor/DK Cellars in
 26 2009. The debtor did not provide a projection for 2009 to ReProp
 27 when it applied for financing. The table includes the sales from
 28 2009 for comparison purposes. It shows a significant

1 deterioration in sales. This is particularly important because
2 at the confirmation hearing Mr. Pratt testified that he expected
3 sales of \$188,978 in 2010 and \$186,730 for 2011. The sales for
4 2009, 2010, and 2011, then, do not suggest a trend indicative of
5 an ability to successfully reorganize.

6 To be sure, the debtor believes that even with sales in the
7 neighborhood of \$190,000 it can pay its operating expenses and
8 fund the proposed plan. However, the margin for error is razor
9 thin. According to the 2010 projection offered at the hearing,
10 Exhibit M, the debtor projects operating expenses of \$127,554 in
11 2010 and sales of \$188,978, leaving \$61,424 to make plan payments
12 of \$55,800. The debtor will have approximately \$5,600 to spare.

13 However, because the debtor amended the plan, the monthly
14 plan payment will increase by approximately \$652. This will
15 consume the \$5,600 surplus and more.

16 And, even if the increase in the plan payment is not
17 retroactive, the projections for 2011 are no better. In fact,
18 they are worse. They show \$186,730 in sales, and \$130,762 in
19 operating expenses. The net amount of \$55,968 is barely enough
20 to satisfy the \$55,800 in plan payments even assuming they remain
21 at \$4,650 a month. If the plan payments increase by \$652 a
22 month, the debtor's shortfall in available income increases.

23 Even if the financial forecast can be massaged to a
24 breakeven point, the forecast departs materially from the
25 debtor's history and is not credible. Essentially, the debtor's
26 business is a relatively new one, and it has never been
27 profitable. The court does not believe this likely to change, at
28 least with the debt load that the debtor must service.

1 There is a further feasibility problem. The plan, as
2 amended, does not fully amortize ReProp's claim. As indicated
3 above, when it matures in 16 years, there will be a balance of
4 approximately \$240,000. There is nothing in the record that
5 permits the court to conclude that the debtor will be able to pay
6 this sizeable lump sum when it falls due.

7 It appears, then, that the debtor/DK Cellars expanded the
8 winery on a shoestring and out of financial desperation incurred
9 an expensive short-term loan from ReProp. When sales did not
10 increase as projected, they defaulted on the obligation owed to
11 ReProp and now the debtor hopes to turn that financing into a
12 long-term obligation. Even though such long-term financing is
13 not available to this debtor in the marketplace, such a plan
14 might be confirmable provided it is feasible. Having proposed a
15 long-term maturity, the debtor is required to demonstrate its
16 long-term prospects. The debtor has not met this burden.

17 There is further reason to doubt the debtor's financial
18 viability. As noted above, the Pratts filed a chapter 13
19 bankruptcy in 2009. In their schedules they valued this
20 debtor/DK Cellars as having no value. The value of a corporate
21 entity is a reflection of both its assets and its ability to make
22 a profit. The fact that the Pratts have informed the court in
23 their own bankruptcy that the debtor has no value, is an
24 admission that the debtor's financial viability is marginal at
25 best.

26 Therefore, without the prospect of a further equity infusion
27 or a sale of the vineyard or the winery, the court concludes that
28 the debtor cannot successfully reorganize. It is unnecessary to

1 address the other objections raised by the creditor.

2 A separate order will be entered denying confirmation of the
3 plan.

4 Dated: December 9, 2010 By the Court

5 
6 Michael S. McManus, Judge
7 United States Bankruptcy Court

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CERTIFICATE OF MAILING

I, Susan C. Cox, in the performance of my duties as a
judicial assistant to the Honorable Michael S. McManus, mailed by
ordinary mail to each of the parties named below a true copy of
the attached document.

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12 || Dated: December 9, 2010

Musan C. Cox

Susan C. Cox
Judicial Assistant to Judge McManus